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E.O. 12958: N/A
TAGS: ECON EFIN ETRD ENRG ELTN EAIR PGOV SENV MX
SUBJECT: FINANCE SECRETARY BRIEFS AMBASSADOR ON 2010 BUDGET

REFTEL: MEXICO 2709

¶1. (U) This is an action request for Treasury. See Para 9.

¶2. (SBU) SUMMARY. Finance Secretary Agustin Carstens briefed Ambassador on Mexico's 2010 budget, submitted September 8 to Mexico's Congress. . In facing what Carstens described as the "double shock" of the cyclical recession as well as the precipitous decline in Mexico's oil revenue, the GOM's 2010 economic package increases income and excise taxes, and focuses on austerity measures to stabilize the economy. An important factor looming in the executive branch's thinking is the threat of credit-rating downgrade. Carstens said avoiding instability was a necessary first step to retain access to financial markets before taking steps to sow the seeds of competitiveness that might pull Mexico through the recovery and beyond to higher growth levels. The main elements of Mexico's budget include a number of controversial tax increases, expenditure cuts and proposed rule changes in energy, telecommunications and financial services. The GOM attached a short "competitiveness agenda" to the budget, signaling its intention to take on at an undefined time a select number of structural reforms and impediments to growth, for example, changes in labor markets, deregulation in some sectors, a public-private financing plan for infrastructure and strengthening the GOM's antitrust powers. However, this agenda was not part of the budget, and it is unclear how or when the GOM will push it forward. Carstens said he thought the budget was received "reasonably well" considering it included tax hikes, but told Ambassador he expected a lively debate until November 15 when approval by Congress is required. On other issues, Carstens thanked the USG for its continuing help on financial crimes, and welcomed a possible visit by Treasury Secretary Timothy Geithner. END SUMMARY

¶3. (U) Ambassador Pascual called on Mexico's Secretary of Finance and Public Credit (Hacienda y Credito Publico) Agustin Carstens at his office on September 10. The conversation ranged from the budget to Mexico's challenges in improving competitiveness to a possible visit by Treasury Secretary Timothy Geithner this fall. Hacienda's Director for International Affairs Ricardo Ochoa and EconCouns also participated.

¶4. (U) Mexico's budget, submitted to Congress September 8, calls for cuts in spending by 218 billion pesos (USD 16 billion, approximately 1.7% of GDP), eliminates three government ministries, modifies tax rates and tax laws and proposes changes that would create more competition in the energy, telecommunication and banking industries. Spending on social programs has increased overall, and spending on security remains untouched. Total spending, including investments at the state-owned oil company PEMEX, are 3.15 trillion pesos. Non-PEMEX spending would be 2.87 billion pesos. (More

details in REFTEL)

FIRST PRIORITY: FISCAL STABILITY AND REFORM

¶5. (U) On fiscal reform, the government proposes a 2-3 percent increase in personal and corporate income taxes and the imposition of a new 2% "anti-poverty" tax on all goods and services, the proceeds of which would go to social programs for the extreme poor. This tax, dubbed a "VAT in disguise" -- Mexico applies a value-added tax of 15% on everything except food and medicines -- has already surfaced as a political target by opposition party legislators. Income taxes on the agricultural sector, previously capped at 19%, would be increased. Excise taxes on beer, tobacco, telecommunications services (internet etc.) and the lottery were also proposed. Carstens told Ambassador that the response to the budget had been "reasonably good", despite the "lack of euphoria for tax hikes". Rating agencies such as S&P and Fitch were pleased with the proposals, and their seriousness in addressing the government's fiscal challenges.

¶6. (SBU) Facing a potential budget shortfall for 2010 of 3.0 percent of GDP, compared with 2.1 percent in 2009, Carstens stressed the need to increase government revenue and avoid borrowing so as to stave off potential downgrades from credit-rating agencies. Unlike other G20 countries, Carstens said Mexico faced a "double shock" from both the global recession and from the precipitous decline in oil revenue, from which the GOM had previously derived almost 40% of its revenues. Carstens said his budget provided an "exit strategy" to avoid facing what he characterized as an unmanageable debt burden further down the road. He lamented Mexico's poor performance on tax collection, noting that Mexico was last among OECD members and one of the lowest in Latin America.

COMPETITIVENESS?

¶7. (U) Without providing many details, Carstens listed a number of areas where the government planned either administratively or through the Congress to push forward changes that would boost the economy's growth and improve its competitiveness. These included telecommunications, financial services, increasing access to credit, deregulation, the strengthening of the government's antitrust efforts, and making the judicial system more business-friendly. He agreed that President Calderon's proposal during the summit for regulatory cooperation was important, but passed the bureaucratic buck to the Economy Secretary. At this point we have no timeline or schedule for any of these possible reforms.

¶8. (SBU) Carstens told Ambassador that he very much appreciated the continuing assistance and cooperation by the USG on financial intelligence and financial crimes to his Secretariat. Naming Treasury, FinCEN and the DEA, Carstens said he especially found the Embassy's on-the-ground assistance to Hacienda and the Financial Intelligence Unit (UIF in Spanish) very useful and said he hoped it would continue.

VISIT BY TREASURY SECRETARY

¶9. (SBU) Carstens told Ambassador he welcomed a visit by Treasury Secretary Timothy Geithner in the coming months. He stressed how important the U.S. recovery was for Mexico's economic wellbeing and that a visit from his U.S. counterpart could demonstrate that Mexico was "taking the right steps". He said he anticipated that Secretary Geithner's visit could demonstrate good bilateral relations, highlight joint efforts to improve our economies, as well as a common vision of the future and a reassurance to our various publics that "things were getting better". Carstens said he was likely to propose meetings with parliamentary leaders, business and financial leaders, a press event and possibly another event sponsored by the American Chamber of Commerce. Ambassador suggested that the Secretaries might want to include an event on poverty reduction, as well as focus on joint efforts to increase North American competitiveness, as highlighted by the Presidents at the August

North American Leaders' Summit in Guadalajara.

¶10. (SBU) ACTION REQUEST: Embassy would appreciate guidance/input from Treasury regarding a possible visit by Treasury Secretary Geithner.

LETTER TO SECTREAS ON SHARING TAX INFORMATION

¶11. (SBU) Carstens drew the Ambassador's attention to the publication of an article based on a private letter that Carstens had sent to Treasury Secretary Geithner proposing both sides discuss the sharing of tax information, particularly with regard to deposits of Mexican citizens in the United States. He said he had not leaked the letter to the press, and wondered if the leak had come from the U.S. side, either at a lower level or by the Secretary for the strategic purpose of launching a trial balloon. He said he understood why Treasury might want to float the topic publicly, but he wanted to know where the leak came from.

¶12. (SBU) COMMENT. The past several days have witnessed the expected loud protests from opposition parties as well as media commentary that the package maintains a reasonably balanced budget on the backs of the poor and middle class. Amid the protests, some observers suggest that the key elements of the budget, notably the tax increases, were pre-negotiated by the GOM with the opposition. Both Carstens and his Director of Mexico's Tax Administration Service Alfredo Gutierrez have noted publicly that Mexico is one of the countries with the lightest tax burden in the hemisphere. Nevertheless, vested interests are strong.

¶13. (SBU) Though Carstens insisted it was a "question of timing", the budget's main goal, i.e. establishing fiscal stability, is clearly the dominant one. Economists we spoke to who had been briefed by Carstens and his team praised the fiscal reform measures and efforts to plug the deficit. But many voiced concerns that the budget package lacked a long-term vision of how Mexico could improve its competitiveness and arrive at growth rates in the next decade of over five percent. END COMMENT.

PASCUAL